

OFFICE OF THE CITY CONTROLLER



**CITY-WIDE LIABILITIES REVIEW
AS OF JUNE 30, 2003**

Annise D. Parker, City Controller

Steve Schoonover, City Auditor

Report No. 04-01



OFFICE OF THE CITY CONTROLLER
CITY OF HOUSTON
TEXAS

ANNISE D. PARKER

September 29, 2004

The Honorable Bill White, Mayor
City of Houston, Texas

SUBJECT: City-Wide Liabilities Review (Report No. 04-01)

Dear Mayor White:

The City Controller's Office Audit Division has completed a city-wide review of selected liability accounts as of June 30, 2003. The review's objectives included the following:

- Determine whether accounts were valid and properly valued and recorded;
- Determine whether accounts represented authorized obligations;
- Assess the policies, procedures, and internal controls for administering the accounts; and
- Analyze certain accounts with unusual balances and those of a miscellaneous nature.

The report, attached for your review, concluded that internal controls related to the selected city-wide liability accounts are not adequate to provide City Management with reasonable assurance that the accounts are valid and properly recorded. The auditors recommend that the Mayor authorize an Administrative Procedure or Executive Order be written to provide the City a consistent method of managing liabilities; inactive liability accounts be researched by management and adjusted if necessary; and each City Department assign a person to research and reconcile their liability accounts.

The matters contained in the draft report were reviewed by Finance and Administration Department officials. Also, we commend those City Departments that conducted extensive research of ongoing issues discussed during the review, and for taking immediate action on researching their liability accounts to determine their accuracy and validity.

Respectfully submitted,

Annise D. Parker
City Controller

xc: City Council Members
Anthony Hall, Chief Administrative Officer
Michael Moore, Chief of Staff, Mayor's Office
Judy Gray Johnson, Director, Finance and Administration Department

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EXECUTIVE SUMMARY

- Our examination of selected city-wide liability accounts revealed management is unable to rely on the internal controls used to account for these accounts.
- A city-wide Administrative Procedure or Executive Order is needed to provide consistent methods of recording, validating, reconciling and managing the selected liability accounts.
- Inactive liability accounts should be researched and adjusted, if necessary.
- Liability accounts are not reconciled on a periodic basis to test for accuracy and validity.

SCOPE AND PURPOSE


We have completed a city-wide review of selected liability accounts as of June 30, 2003. The scope of our work did not include liability accounts related to payroll, long-term debt, component units, accounts payable, or an evaluation of the overall internal control structure of City Departments. The City Controller's Office Financial and Technical Services Division furnished a listing of all the liability accounts included in the Comprehensive Annual Financial Report (CAFR) to the auditors. Our objectives were to 1) determine whether accounts were valid and properly valued and recorded in the financial system; 2) determine whether accounts represented authorized obligations; 3) assess the policies, procedures, and internal controls for administering and monitoring the accounts; and 4) analyze certain accounts with unusual balances and those of a miscellaneous nature.

Departmental management is responsible for establishing and maintaining a system of internal controls to adequately record and monitor the liability accounts as an integral part of the Department's overall internal control structure. The objectives of a system are to provide management with reasonable, but not absolute, assurance that accounts are recorded properly.

Due to the inherent limitations in any system of internal accounting controls, errors or irregularities may occur and not be detected in a timely fashion. Also, projection of any evaluation of the system to future periods is subject to the risk that procedures may become inadequate because of changes in conditions, or that the degree of compliance with procedures may change.

CONCLUSION

Based on the results of our review, we conclude that overall the internal controls for the selected city-wide liability accounts are not adequate to provide Departments' management with reasonable assurance that the accounts are valid and properly recorded. Further, we recommend that (1) the Mayor authorize an Administrative Procedure or Executive Order be written to provide the City a consistent method of managing liabilities; (2) inactive liability accounts be researched by management and adjusted if necessary; and (3) each City Department assign a person to research, reconcile, and adjust their liability accounts.


Linda McDonald
Auditor-in-charge


Ken Teer
Audit Manager


Steve Schoonover
City Auditor

INTRODUCTION

The Controller's Office auditors conducted a review of selected liability accounts as of June 30, 2003. The review did not include liability accounts related to payroll, long-term debt, component units, or accounts payable. The team focused on accounts with unusual or nonrecurring balances, names, and activities, and those of a miscellaneous nature. The Financial and Technical Services Division of the Controller's Office provided a list of all liability accounts to the auditors. The June 30, 2003 report contained a total of 269 balance sheet accounts, including those accounts with zero balance. When we reduced the 269 accounts to the types considered for our review, the list numbered 128. We judgmentally selected from the 128 liability accounts, 35 accounts, which represented 11 City Departments. Based on the criteria used for reviewing, only one of the 35 accounts had no exceptions.

FINDINGS AND RECOMMENDATIONS

I. LIABILITY ACCOUNTING POLICIES AND PROCEDURES

BACKGROUND

The City of Houston issues Administrative Policies and Procedures (A.P.s) and Executive Orders (E.O.s) designed to establish uniformity of City policy and administration. These provide guidance to management for the uniform administration and coordination of its functions. Executive Orders address the need to establish organizational responsibilities of City Departments and managers for certain processes. For example, E.O. 1-30 established the creation of a *Fixed Asset Accounting Policies Manual*, and states that this manual be followed by all City Departments.

FINDING

There is no city-wide A.P. or E.O. written to address consistent accounting policies and procedures for the control, recording, reconciling, management, and validity of the types of liability accounts we included in the scope of our review. Of the 35 accounts we analyzed, only seven (20%) had an internal written policy for the accounting and reconciling of the account. The City has approximately \$16 million recorded in the financial system for the types of liability accounts we reviewed at June 30, 2003. Currently, each City Department determines how to account for its liabilities, and there is no city-wide consensus in the methodology used.

RECOMMENDATION

We recommend to the Mayor that an A.P. or E.O. be written for the handling of liabilities. This would provide the City a consistent method of recording, validating, reconciling and managing the liabilities.

II. INACTIVE LIABILITY ACCOUNTS

FINDING

As part of the review, we compared ending balances of all the liability accounts at June 30, 2002 and June 30, 2003, in order to determine if activity occurred within the account for fiscal year 2003. The total of all 269 liability accounts at June 30, 2003 was approximately \$13 billion. We noted various accounts totaling approximately \$1.4 billion had the same balance at June 30, 2003 as it did on June 30, 2002. This inactivity within liability accounts raises questions regarding the validity of the balances in the accounts. Our sample of 35 accounts contained 24 of these repeat balances. Of the 24 accounts, it was determined that 23 should be adjusted.

RECOMMENDATION

We strongly recommend that City Departments' management research their liability accounts to determine their accuracy and validity, and make adjustments, if necessary. Additionally, we recommend the proposed A.P. or E.O. discussed in Finding I, also address this issue.

III. PERIODIC RECONCILIATION OF LIABILITY ACCOUNTS

BACKGROUND

Sound accounting practice includes periodic reconciliations of accounts. Performing a reconciliation helps 1) ensure that liabilities charged to the Department's accounts were properly approved and valid; 2) ensure the transaction was recorded correctly and timely; and 3) provide a basis for resolving and correcting problems as they occur.

Our criteria included reviewing for 1) reconciliations; 2) supporting documentation; 3) validity; and 4) proper recording of the account. Of the 35 accounts analyzed based on the criteria, only one had no exceptions, and several of the remaining 34 accounts had numerous exceptions. Our findings are as follows:

FINDING

- Reconciliations of the selected liability accounts had not been performed on 29 of 35 (83%) selected liability accounts;
- Twelve of 35 (34%) did not have adequate supporting documentation.

The auditor's review of the accounts resulted in determining that 23 of the 35 accounts (66%) should be either adjusted to zero, or the balance was incorrectly recorded and should be transferred to a different liability account. Those accounts are broken down as follows:

- Eleven of 35 (31%) had been written down to zero by the appropriate Department as of the completion of fieldwork;
- Five of 35 (14%) require the Controller's office to determine the disposition of the accounts due to the fact that the original purpose of the account cannot be determined;
- Three of 35 (9%) were incorrectly recorded and will be adjusted by the Department;
- Two of 35 (6%) need to be escheated to the State;
- Two of 35 (6%) are awaiting a legal opinion from the City attorneys as to whether the accounts can be written to zero.

RECOMMENDATION

We recommend each Department assign a person to reconcile their liability accounts. The frequency of the reconciliations should be determined by Department Management (e.g. monthly, quarterly, semi-annually, based on cost effectiveness). This person should not only reconcile the accounts, they should also be held responsible for corrections and disposition of the account as needed, with Department Management approval. We also recommend Department Management maintain copies of supporting documentation of their liability accounts. Additionally, we recommend the proposed A.P. or E.O. discussed in Finding I, also address this issue.